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No. 95-860

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

BARBARA SMILEY,
Petitioner,
v.

CITIBANK (SOUTH DAKOTA), N.A.,
Respondent.

On Writ of Certiorari to the
California Supreme Court

BRIEF FOR *AMICI CURIAE* AFFINITY GROUP MARKETING AND CREDIT UNION NATIONAL ASSOCIATION, INC. IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI* [1]

Affinity Group Marketing ("AGM") is a closely-held corporation in the business of developing and marketing affinity credit card programs. AGM is the developer of an affinity card program for the American Federation of Labor-Congress of Industrial Organizations ("AFL-CIO"),

[1] Pursuant to Supreme Court Rule 37.3, copies of letters from Counsel for Petitioner and Counsel for Respondent consenting to the filing of this brief have been filed separately.

generally referred to as the Union MasterCard Program. The Union MasterCard Program is a joint program of AGM, The Bank of New York (Delaware), and Union Privilege, AFL-CIO (a subsidiary of the AFL-CIO that provides benefit programs for members of AFL-CIO affiliated labor unions).

The credit cards issued under the Union MasterCard Program are available to members of AFL-CIO affiliated labor unions and their families. Approximately 3,300,000 union members and their families throughout the nation have credit cards issued under this program, with more than $3.5 billion in currently outstanding balances. The Union MasterCard is offered on terms that are specially designed and negotiated for members of AFL-CIO affiliated labor unions. For example, the variable finance charge rate is low, and members are allowed to skip a specified number of monthly payments during a union-sanctioned strike and/or for certain fixed months during the year. The Union MasterCard terms include a late charge of $15.

Credit Union National Association, Inc. ("CUNA") is the principal national trade association for credit unions in the United States. It consists of 51 credit union leagues covering the fifty states and the District of Columbia. About 90 percent of the approximately 12,350 federal and state-chartered credit unions in the United States are members of these CUNA leagues. CUNA represents the interests of these credit unions in legislative and regulatory matters. CUNA and its affiliates also provide a wide range of support services to credit unions, including credit card processing and support for approximately 2,300 credit unions with almost five million credit cardholders. Credit unions affiliated with CUNA are owned by their member-customers, whose elected representatives set the credit unions' rates of charge for credit cards and other services.

Amici have a substantial interest in the issue to be decided in this case. Union MasterCard's credit card terms include late charges, which are authorized under federal banking law[2] and the laws of the state where the issuing bank is located. The card programs of many of the CUNA-affiliated credit unions also include late charges.[3] These institutions charge late fees to delinquent borrowers because doing so allows the institutions to charge lower monthly finance charges to members who pay on time.

Amici believe that Petitioner, who has admittedly paid late in violation of her credit card agreement, and who seeks to represent the small minority of other credit cardholders who pay late, does not accurately reflect the interests of consumers generally. *Amici*, who represent large and diverse membership groups, believe that their policies reflect a fair view of the interests of the vast majority of credit cardholders. They believe that lenders whose home state laws permit late charges should continue to be able to offer cardholders the choice of credit cards with low finance charges coupled with late fees, thereby allocating costs of delinquency more appropriately to those borrowers whose conduct imposes higher costs on the system. *Amici* believe that the applicable federal

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[2] The Bank of New York's charges are governed by 12 U.S.C. § 1831d, which was modeled on, and is nearly identical to, 12 U.S.C. § 85 ("Section 85"). *See, e.g., Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 826-27 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993); Letter from Douglas H. Jones, FDIC Deputy General Counsel (July 12, 1993), *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,635 (Opinion No. 93-27); Letter from Douglas H. Jones, FDIC Deputy General Counsel (July 8, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,534 (Opinion No. 92-47).

[3] The loan charges of state-chartered, federally-insured credit unions, which constitute about half of CUNA's members, are governed by 12 U.S.C. § 1785(g), which is also nearly identical to 12 U.S.C. § 85. Letter from Richard S. Schulman, NCUA Acting Associate General Counsel (Apr. 11, 1994), *reprinted in* 62 Banking Rep. (BNA) 766 (Apr. 25, 1994).

laws do not allow such lenders to be subjected to regulatory limits on such charges imposed by other states where borrowers may live or use their cards.

SUMMARY OF ARGUMENT

Card issuers such as *Amici* Issuers[4] should be free to offer their cardholders or members credit cards with a package of pricing terms that minimizes the costs to those borrowers who meet their payment obligations on time. They should be free to impose the additional costs associated with delinquencies on those customers responsible for the costs associated with late payment, especially since the erratic payment histories of those cardholders who fail to meet agreed-upon payment deadlines indicate that they pose a greater risk of nonpayment. As long as the laws of their home states permit such pricing packages, *Amici* Issuers should not be forced to modify their otherwise uniform, nationwide credit plans to accommodate the varying laws of states where their borrowers live or shop.

The term "interest" in the applicable federal laws encompasses all the terms of credit card pricing packages that constitute "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873). Late payment fees meet this definition, and should be treated as "interest" under federal law, thus permitting lenders like *Amici* Issuers in states whose laws allow such charges to impose them in order to reduce the cost of credit to borrowers who pay on time.

An artificially narrow interpretation of "interest" that excluded late charges would undermine the national lending market that Congress sought to foster when it enacted 12 U.S.C. § 85. *See Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978). For the national financial market to prosper, it is crucial to financial institutions like *Amici* Issuers that the "exportation" principle described by the Court in *Marquette* apply to all lending charges, not just the periodic percentage rate. The Union MasterCard Program and many CUNA-affiliated credit unions have established credit card programs specifically designed to provide members with uniform, non-discriminatory terms nationwide. Many of the smaller institutions, which have credit card programs serving people spread over a large number of states, could not continue to operate if they had to conform their charges to the requirements of every state.

In establishing their card programs and pricing packages, *Amici* Issuers have relied on the guidance of their regulators, who have advised the industry for years that the term "interest" in the statutes they administer includes late charges and other similar elements of credit card pricing packages. This administrative guidance, and reliance on it, is entitled to substantial weight in interpreting the banking statutes.

[4] As noted above, AGM is associated with the Union MasterCard Program, which The Bank of New York issues from Delaware. CUNA-affiliated credit unions issue credit cards from all fifty states. For purposes of simplicity, we refer herein to the issuers of all of these various credit card programs as "*Amici* Issuers."

ARGUMENT

I. "INTEREST" INCLUDES THE ENTIRE PACKAGE OF LENDING CHARGES AGREED TO BY LENDERS AND BORROWERS.

Like Citibank, AGM's Union MasterCard Program and CUNA-affiliated credit unions collect different kinds of charges under their credit card programs that, together, form a package that compensates them for the use, forbearance, or detention of their money. For example, AGM's Union MasterCard Program is able to offer cardholders a low periodic finance charge and the right to defer payments under certain circumstances, in part because it recoups costs associated with delinquency

through a late charge levied on cardholders who do not make payments on the dates when they are required. The various credit union affiliates of CUNA offer a variety of lending packages similarly tailored to their particular needs and those of their members, many including late fees. In *Marquette*, this Court recognized the existence of these packages and the tradeoffs they involve for both the lender and the borrower. 439 U.S. at 302-03.

The late charges in these packages are not, of course, designed to collect from each delinquent borrower the precise share of cost he or she imposes on the system; that would be wholly impractical. But they are designed to reflect these costs in packages that will be attractive to the members of these groups.

There is no reason to distinguish, for purposes of regulatory jurisdiction, among the lending charges in these packages, with the consequence that some of the lending charges are governed by one set of laws (federal and the financial institution's home state) and others are governed by various other sets of laws (including all the states in which borrowers reside or shop). All of the charges in these packages constitute "interest" as that term is generally understood in the law. Indeed, the classic definition of "interest," expressed by this Court more than a century ago, is all "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." [5]

Moreover, as an economic matter, there is no reason to distinguish among various loan charges, which are different parts of the total compensation the lender receives

[5] *Brown v. Hiatta*, 82 U.S. (15 Wall.) 177, 185 (1873); *see also Shoemaker v. United States*, 147 U.S. 282, 321 (1893) ("Interest accrues either by agreement of the debtor to allow it for the use of money, or, in the nature of damages, by reason of the failure of the debtor to pay the principal when due.").

for making loans. If financial institutions are unable to recover their costs and earn a profit through certain kinds of charges, they must increase other charges in order to achieve the same level of compensation. The same body of law should govern all of these mechanisms by which financial institutions are compensated for their loans, including late charges.

II. LATE CHARGES ARE A FAIR AND EFFICIENT WAY TO ALLOCATE THE COSTS OF DELINQUENCY TO CARDHOLDERS WHO PAY LATE.

The late charges at issue here are appropriate ways to allocate certain costs of credit to those customers who impose the costs on the card system. Petitioner and other members of the purported class failed to make minimum payments by the days specified in contractual agreements they entered into. Although Petitioner and her lawyers paint themselves as representatives of all cardholders and argue that late charges are contrary to the interests of all of them, this is not correct. As one distinguished economist has put it:

> Prohibitions on late charges fail to protect consumers. Instead, they "protect" people who pay late by making such behavior costless. Indeed, more people will pay late if there is no cost to them personally. However, there is a cost associated with late payments, and this is borne by the credit card users who honor their agreements. What these prohibitions do, then, is to subsidize those who pay late at the expense of those who pay on time. . . . That is not a desirable outcome if "the greater good" is what we hope to achieve.

William C. Dunkelberg, *Litigation Concerning Late Charges Is Major Threat To Credit Card Business*, Banking Pol'y Rep., Apr. 6, 1992, at 1, 16 (available on LEXIS).

Failures to make payments by their agreed due dates impose several different costs on the lender. First, the

delinquency lengthens the loan, and longer-term money generally costs more than short-term money. Robert E. Litan, *The Economics of Credit Cards* 7 (1993). Second, delinquency imposes increased costs of loan administration and tracking. *Id.* Third, the lender has costs for collection machinery. Finally, delinquent borrowers are more likely to become defaulting borrowers:

> When a customer is late in making his or her required minimum payment, that action is a signal to the issuer that the customer is much more likely to default on the entire balance than customers who pay on time. . . . [D]ata show that the chargeoff rate of customers who at one point have been assessed a late fee has been between four to six times higher than the credit losses on all accounts generally.

Id. (emphasis omitted); *accord* William F. Baxter, *The Economic Benefits of Federal Preemption and Deregulation of the Credit Card Industry*, 1995 Utah L. Rev. 1009, 1025 (forthcoming). To compensate for these increased risks and costs, a financial institution must either charge late fees of some sort or raise some other charge, such as the monthly finance charge on all balances. The vast majority of *Amici* Issuers' cardholders (for example, 97.62% in the Union MasterCard Program) either do not incur late charges and similar charges or do so only rarely, and it is unfair that they should pay higher monthly finance charges in order to subsidize those members whose payment patterns make them subject to late charges. *See* Robert E. Litan, *supra*, at 8 ("It is also fair and efficient to charge a fee to cover the increased risk of nonpayment. To do otherwise—that is, to spread the costs of collecting on their late accounts among all card users—would be to penalize the timely-paying customers.").

It is also appropriate and practical to state late charges as flat amounts rather than percentages. Flat amounts are often clearer and more easily understood by customers. Moreover, the extra costs that delinquent

borrowers impose are *not* proportional to the amount that is late, and because of the small size of many credit card delinquencies, a percentage that is sufficient for a small delinquency would be too high for a larger amount.

For these reasons, early in the development of the Union MasterCard Program, the AFL-CIO decided that flat late charges would be part of the program's credit card terms, in order to keep the monthly finance charge for on-time members as low as possible. Similarly, many credit unions—nonprofit organizations that are owned by their customers and set their prices to meet member needs—include late charges in their price terms in order to keep the ordinary monthly finance charges down and allocate costs fairly.

III. IT IS IMPORTANT THAT FINANCIAL INSTITUTIONS BE ALLOWED TO CONTRACT FOR FEES ON A UNIFORM BASIS NATIONWIDE.

Section 85 authorizes the "exportation" of "interest" rates. That is, a bank may properly charge the rates allowed by its home state to everyone who chooses to do business with it, even if the cardholder resides in a jurisdiction that imposes a lower ceiling or different restrictions on lenders within its jurisdiction. Contrary state law "must, of course, give way." *See Marquette*, 439 U.S. at 318 n.31. This principle applies to all aspects of the financial institution's "interest" charges, including late fees.

It is critical to nationwide credit card programs, such as the Union MasterCard Program and the programs of many of the CUNA-affiliated credit unions, that they not be required to discriminate against some cardholders by offering them different terms because of where they happen to live or shop. For example, the Union MasterCard Program was developed and negotiated based upon the strength of the over 13½ million members of the AFL-CIO affiliated unions taken as a group. Because the

finance charge, late charge, and other charges are interrelated, if different late charge restrictions were applied in different states, members in one state might well end up subsidizing members in another state. A cardinal rule of labor relations is the equal treatment of people, and it would break a bond of fellowship among union members if the members in different states had to be charged different rates for money that comes from the same source. It would likewise be inappropriate for a credit union to be required to discriminate in its pricing terms between members, who all have the same ownership and voting rights in the institution, merely because some of them live in a different state.

Requiring these credit card issuers to differentiate among cardmembers based on where they reside would seriously undermine their national credit card programs for an additional reason. The membership bases of many of these institutions are widely dispersed across the United States and the world, and they are highly mobile. If the institutions were required to conform their late charges and other charges to the rates specified by the local laws of each jurisdiction where customers reside or shop, and to adjust those terms when customers change residences or shop in a different state, the administrative costs (including legal costs, computer costs, accounting costs, marketing costs, costs of maintaining many different sets of standard contracts, and training costs for account service personnel) would be very substantial. These costs would be particularly onerous for a small credit union, which does not have a large membership base over which to spread the costs.

This Court made clear in *Marquette* that the purpose of 12 U.S.C. § 85 was to create a "national" financial market for financial institutions and their customers. If a customer is unable to obtain credit on the most favorable terms from lenders in his or her own jurisdiction, Congress intended not only that the customer could borrow

from a financial institution in a different jurisdiction, but also that he or she could borrow on the terms allowed by the law of the financial insitution's state. *Marquette,* 439 U.S. at 314-19. This Congressional design fosters interstate competition among financial institutions and increases the variety of options available to customers. A customer is always free to deal with a local institution at rates set by local law, but the intent of the federal banking laws is to allow borrowers the alternative of dealing with lenders governed by other states' rate restrictions instead.

Excluding late charges from the scope of the term "interest" in 12 U.S.C. § 85 would undermine the practical effect of the decision in *Marquette* even as to a financial institution's monthly finance charge ("APR"). As noted above, late charges are a material financial term on a credit card account and can have a significant impact on the level at which the APR is set. Thus, for example, a low-APR lender would need to consider adjusting its APR in some or all jurisdictions in response to any limits on its late charges. Such state-by-state adjustments would not serve the interests of the financial institution or its non-delinquent cardholders, and they would run counter to the principles underlying *Marquette*. Therefore all aspects of the price that cardholders pay for credit—whether it is the monthly finance charge, late charge, or other charges —must be recognized as part of the "interest" package that the financial institution is authorized to charge.

IV. FINANCIAL INSTITUTIONS HAVE JUSTIFIABLY RELIED ON THE LONGSTANDING OPINIONS OF THEIR REGULATORS.

The terms of the Union MasterCard credit card program, and those of CUNA's affiliates and other financial institutions, have been established in reliance on long-standing regulatory interpretations of the federal banking laws issued by the federal bank regulatory agencies. As

Respondent describes in its brief, those legal interpretations are entitled to substantial judicial deference.

Late charges for delinquent payers are not a recent innovation. The Office of the Comptroller of the Currency ("OCC") opined as early as 1955 that late charges on consumer accounts are governed as "interest" by 12 U.S.C. § 85 (Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955)), and it reiterated the point again last year (Letter from Julie L. Williams, OCC Chief Counsel (Feb. 17, 1995), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,618 (Interpretive Letter 670)). Most recently, the OCC issued a regulation, after notice and comment, codifying the principle. 61 Fed. Reg. 4849 (1996) (to be codified at 12 C.F.R. pts. 7 and 31). The other federal banking agencies, construing almost identical statutes governing other types of financial institutions, have over many years consistently reached the same conclusion.[6]

Here is an important instance in which federal law has been very clearly and explicitly spelled out by the appropriate agencies for the guidance of an industry and organizations such as *Amici* Issuers. Their programs have been established in reasonable reliance on those agency interpretations, and the specific terms of their accounts

[6] *See, e.g.*, Letter from Karen Solomon, OTS Deputy Chief Counsel (Sept. 29, 1994), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 82,852 (Opinion No. 94/CC-18) (thrifts); Letter from Douglas H. Jones, FDIC Deputy General Counsel (July 8, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,534 (Opinion No. 92-47) (federally insured state-chartered banks); Letter from Harry W. Quillian, FHLBB Acting General Counsel (June 27, 1986), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 82,852, at 62,403 (thrifts); Letter from Richard S. Schulman, NCUA Acting Associate General Counsel (Apr. 11, 1994), *reprinted in* 62 Banking Rep. (BNA) 766 (Apr. 25, 1994) (credit unions).

are clearly stated in the agreements given to each cardholder with his or her credit card. Much has been staked on this guidance. These legitimate reliance interests in financial affairs should be given substantial consideration. *See, e.g., Zenith Radio Corp. v. United States*, 437 U.S. 443, 457-58 (1978) ("In light of these substantial reliance interests, the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons.' " (citations omitted)).[7]

CONCLUSION

For the foregoing reasons, the judgment of the California Supreme Court should be affirmed.

Respectfully submitted,

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[7] Petitioner's reliance on *Harper v. Virginia Department of Taxation*, 113 S. Ct. 2510, 2516 n.9 (1993) (Pet. Br. at 48), is misplaced. The issue that the Court addressed in the footnote Petitioner cites involved the retroactive application of " 'a new principle of [constitutional] law,' " *id.* at 2516 (citation omitted), not the deference owed to an agency interpretation on which an industry has relied for many years.